

MARKETS

Hu-Obama deal supports First Eagle investment thesis

Last week's summit in Washington supports portfolio manager Colin Morris's contention that US equities are the "least bad" option for investors.

By [Jame DiBiasio](#) | 27 January 2011

Last week, Chinese President Hu Jintao's state visit to the White House culminated with US President Barack Obama announcing commercial deals involving \$45 billion of sales by US manufacturers to China, and a commitment from Beijing to improve intellectual property rights.

This fits in perfectly with Colin Morris's investment thesis that, for 2011, US equities are the "least bad" option. Morris is portfolio manager in New York at First Eagle Investment Management, responsible for US equity portfolios.

Speaking with AsianInvestor prior to last week's summit, Morris says the ground between China and America's commercial interests is gradually shifting, to the advantage of US manufacturers.

"Global economic imbalances remain extreme, but what is new is the recognition of the problem," Morris argues. "The old acceptance of China dumping cheap goods into international markets has gone."

That is down to several reasons, but results in a bigger willingness for politicians in the US and elsewhere to push for a different term of trade. Big US corporations, which once championed trade with China, have been lobbying against perceived unfairness in China. The Obama administration, feeling stung from Chinese pushiness during Obama's previous visit to Beijing and desperate to generate jobs at home, has taken a much tougher line.

The bottom line is that US producers are regaining a measure of pricing power at a time when they are cash-rich and financially sound. "Imbalances cannot last forever," Morris says. "This creates opportunities for US manufacturers."

He says fund managers are prepared to stake big bets on those US companies that have successfully restructured, noting the success of Ford and General Motors in regaining competitiveness against Japanese peers. (He did not comment on whether he owns these particular names.)

Surveying a list of investment options, Morris says US equities are the best bet for 2011. "US equities give us the most opportunity to invest in different ways and create diversification," he says.

For example, he says liquid stocks can serve as a substitute for real assets, such as oil and gas companies, fertilizer companies and timberland operators. Morris also manages a long/short equity portfolio that owns real assets via futures, but currently he says stock prices trade at a discount to future spot prices.

He believes equities stack up well against credit, calling high yield a "slam dunk" for 2008 and 2009, but a window that has closed quickly.

Among equities, although he likes companies engaged in global infrastructure and emerging-market consumption, these have gone from bargains to fairly valued in very short order. He says the next move will be in US companies exposed to the domestic economy, which have gone ignored. "They may not be bargains, but they offer good value," he says.

Even fairly valued multinationals selling into emerging markets are more attractive than their credit, Morris argues. Many of these companies have no debt and can afford to raise their dividend levels if they do well in an improving world economy. Meanwhile, a bond with a 5-7 year duration is at risk of losing its principal if economic growth prompts a rise in interest rates.

Morris favours stories in wireless telecoms, automobile electronics manufacturers, and providers to the US military and aerospace companies. He also likes big US regional banks, whose share prices reflect negative expectations but which enjoy a low cost of capital and strong distribution power – any economic upswing will benefit these banks. US banks are also viewed as having restructured while European peers have not.

The US equity story is not without risk, and Morris notes that it is indeed the least bad one, as opposed to a bullish scenario. He notes the US government is on track to add \$3 trillion of debt over the next two years, and the December tax deal effectively delayed any further action until the 2012 election.

The Federal Reserve's \$600 billion asset purchasing programme ends this June, and if the economy isn't seen as adding jobs, authorities will be left with unappetising choices. If the combination of fiscal and monetary stimulus does improve the employment picture, it could create an atmosphere of rising tax revenues and economic growth – which will make those deficit-reduction talks in 2012 a lot more palatable.

If the US can't jumpstart its economy and job creation, however, then equity investors will find "least bad" isn't very good at all.

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